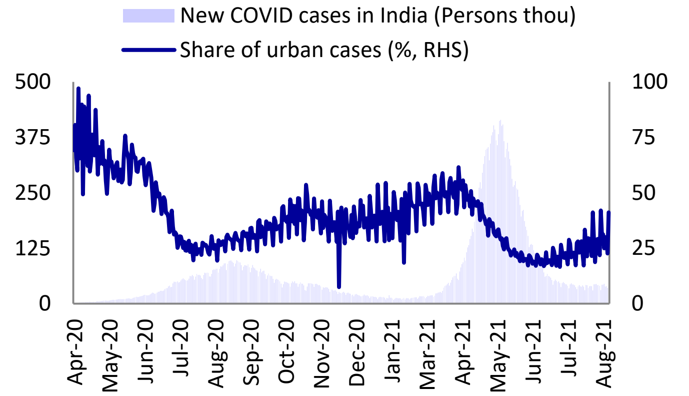
ECOSCOPE
The Economy Observer

Rural consumption still strong in 1QFY22…

…and low base supported urban consumption

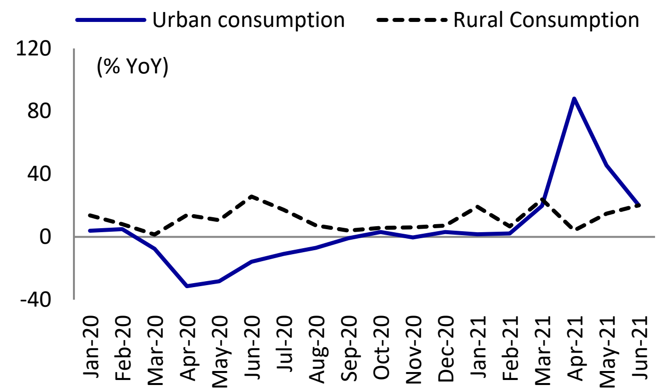
- The second COVID-19 wave was very severe in India. Although its economic impact was limited vis-à-vis the first wave, it is believed to have hurt the rural segment more adversely than the urban population of the society. In this note, we compare the adverse impact of the (national) lockdown during the first wave and that of the (localized) lockdowns in the second wave on rural and urban consumption. The penetration of the second COVID wave in the hinterland implies that more than three quarters of the new infections over May–Jul'21 have been in the rural districts of the country. However, this did not have a majorly adverse economic impact on rural society.
- Using various proxy indicators to analyze consumption trends, our analysis suggests rural consumption (using nine economic indicators) grew 6.6% YoY in 1QFY22 vis-à-vis growth of 16.4% YoY seen in 1QFY21. In contrast, urban consumption (using seven indicators) surged 27% YoY during the last quarter, primarily on a low base of -18% YoY in 1QFY21. In other words, despite the second COVID wave, rural consumption continued to grow in 1QFY22.
- Moreover, our in-house Economic Activity Index (EAI) indicates that while the Farm and Non-Farm sector GVA remained strong, the latter outperformed the former in 1QFY22 on account of a low base. This further indicates that real private consumption expenditure (PCE) is likely to come in stronger in 1QFY22. Data indicates that the turnaround in real PCE in 4QFY21 was also led by relatively better performances from both the rural and urban sectors in 4QFY21.
- On the contrary, natural factors such as southwest monsoon rainfall as a percentage of normal rainfall and kharif sowing as a percentage of normal sowing are performing worse this year vis-à-vis the previous year. Besides this, government support in terms of rural spending declined massively in 1QFY22, and farmers' terms of trade (the difference between farmers' input cost and output price) are unfavorable this time around. Therefore, natural factors are discouraging for the Farm sector within the rural sector.
- In conclusion: (1) It is clear that the rural sector did weaken a bit during the second wave, but the situation was not as bad as was feared. (2) The very high urban consumption in 1QFY22 does not necessarily imply a rebound in consumption demand as much of it was due to a very low base. (3) A weak Farm sector (due to frail government aid and worse natural factors) within the rural sector does not bode well for the rural economy. (4) Although the second wave has subsided, the fear of a potential third wave could derail economic growth once again. (5) Although we believe PCE may have seen a sharp rebound in 1QFY22, primarily on a low base, sustained growth in consumption in subsequent quarters would eventually matter for economic recovery as a whole.

Exhibit 1: The far worse second COVID wave penetrated largely in the rural sector…



Using Census 2011 data, districts which have rural population >50% of total population are assumed rural districts. Data as of 10th Aug'21.

Exhibit 2: …but rural consumption was not affected as badly as was feared



Source: Census 2011, CEIC, CSO, RBI, Various National Sources, MOFSL

Nikhil Gupta – Research Analyst (Nikhil.Gupta@MotilalOswal.com)
Yaswi Agarwal – Research Analyst (Yaswi.Agarwal@motilaloswal.com)

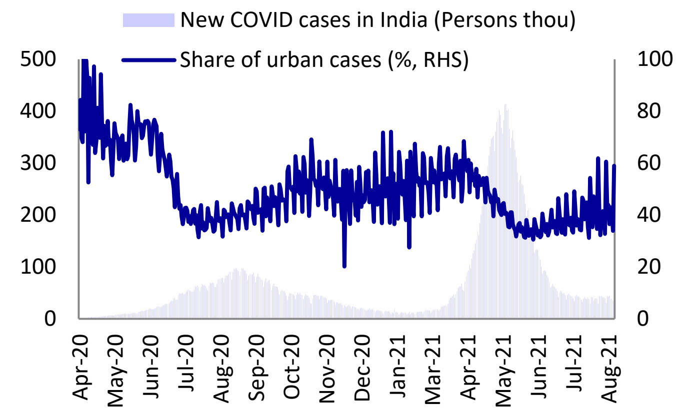
The rural sector claimed a higher share in COVID cases during the second wave…

After reaching a peak of 85–90k new cases on average in the second half of Sep'20, cases started reducing to reach lows of 22k new cases as of 31st Dec'20. As the vaccination program began in Jan'21, new infections declined further. However, the respite was short-lived. From Mar'21, daily new infections started rising once again, with the virus being highly transmissible this time around. Daily new cases reached highs of 414k as of 7th May'21, marking the peak of the second wave *(Exhibit 3).*

Besides the fact that the second COVID wave was far more dangerous than the first, there was one more stark difference. While COVID-19 had primarily impacted the urban sector initially, **the penetration of the second COVID wave in the hinterland implies that almost three quarters of the new infections over May–Jul'21 will have been in the rural districts of the country** *(Exhibit 4)*.

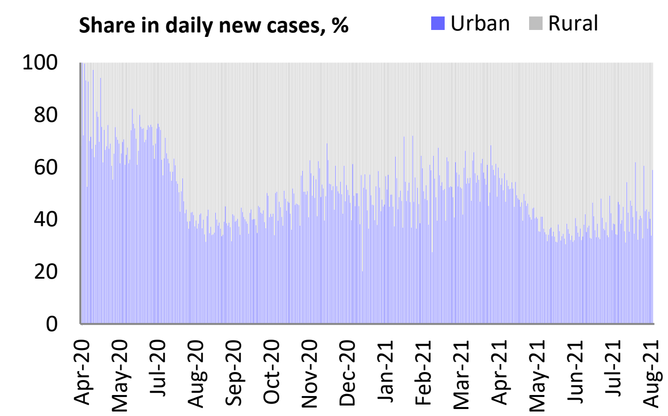
In this note, we compare the adverse impact of the (national) lockdown during the first wave with that of the (localized) lockdowns during the second wave to re-examine the trends in rural and urban consumption. However, our analysis shows this did not have a majorly adverse economic impact on rural society.

Exhibit 3: The second COVID wave was far worse than the first…



Using Census 2011 data, districts which have rural population >50% of total population are assumed rural districts.

Exhibit 4: …with a higher share of rural sector infections in total new infections



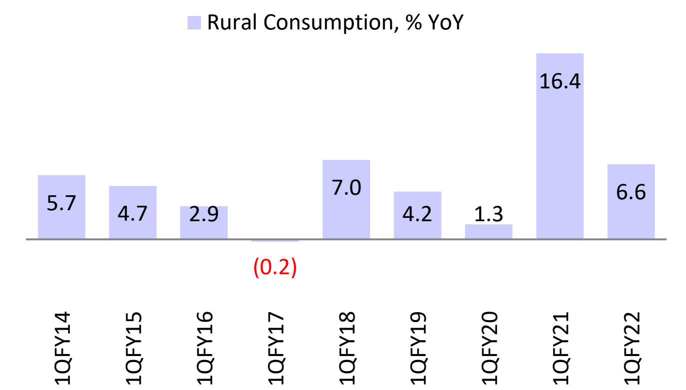
Data as of 10th Aug'21

Source: Census 2011, CEIC, covid.org, MOFSL

…but rural consumption continued to grow, albeit slowly

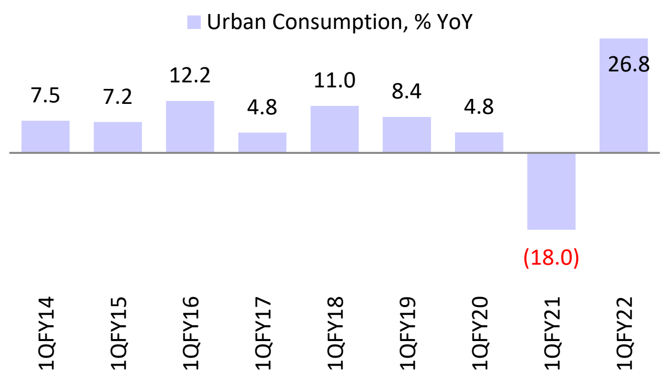
Since there are no official statistics on rural and urban consumption to help us get a better understanding of these trends, we use several proxy indicators for rural and urban consumption. Data suggests rural consumption (using nine economic indicators) grew 6.6% YoY in 1QFY22 compared with growth of 16.4% YoY seen in 1QFY21. Admittedly, this implies rural consumption has taken a beating, but is still stronger than the average growth of 3.7% YoY witnessed during the first quarters of the seven years before COVID *(Exhibit 5)*. Urban consumption (using seven economic indicators), on the other hand, grew sharply by 27% YoY in 1QFY22, primarily on account of the low base of -18% YoY of 1QFY21 *(Exhibit 6)*.

Exhibit 5: Rural consumption moderated in 1QFY22, but was still strong v/s pre-COVID years…



Compiled using nine indicators – 1) Real Agri wages, 2) Real non-agri wages, 3) Farmer terms of trade, 4) Agriculture exports 5) Fertilizer sales, 6) Agriculture credit, 7) IIP food products, 8) Reservoir levels and 9) Fiscal rural spending

Exhibit 6: …and urban consumption surged during the second wave due to the very low base of the first wave



Compiled using seven indicators – 1) Employee cost of BSE500 companies, 2) CPI non-food inflation, 3) Personal credit, 4) IIP Consumer durable goods, 5) Petrol consumption and 6) Real House Prices and 7) Non-farm consumer imports

Source: CSO, RBI, Various Other Source, CEIC, MOFSL

Turnaround in real PCE was led by both rural and urban consumption in 4QFY21…

Real PCE grew 2.7% YoY in 4QFY21, after declining 13.1% YoY in 9MFY21. This was led by 16.4% YoY growth in rural consumption and 11.7% YoY growth in urban consumption in 4QFY21 *(Exhibits 7, 8)*.

Exhibit 7: Real PCE grew 2.7% YoY in 4QFY21, after contracting 13.1% YoY in 9MFY21…

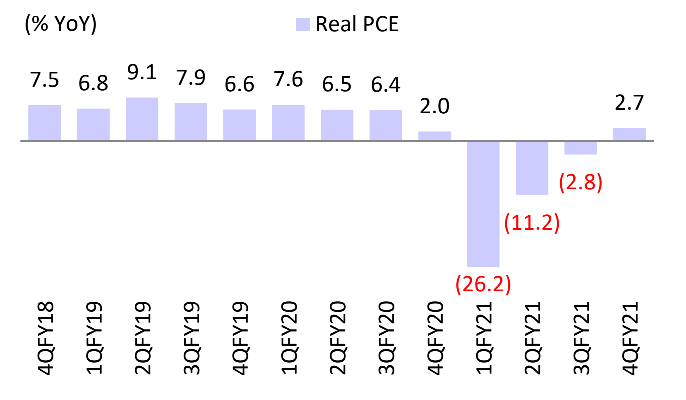
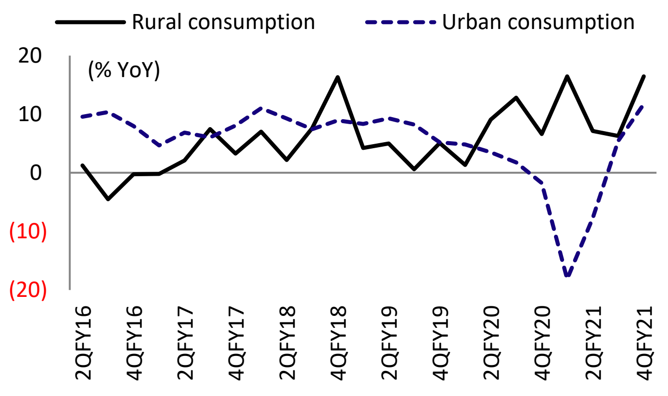


Exhibit 8: …on account of strong growth in both rural and urban consumption during the quarter



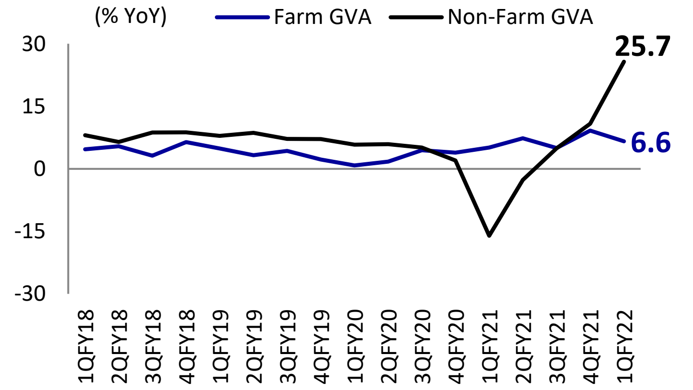
Source: CSO, RBI, Various Other Source, CEIC, MOFSL

…and non-Farm sector outperformed Farm sector in 1QFY22

According to our recently released Economic Activity Index (EAI) update for Jun'21/1QFY22, Farm sector GVA grew 6.6% YoY in 1QFY22 (v/s growth of 9.2% YoY in 4QFY21, but higher than 5.1% YoY in 1QFY21). On the other hand, Non-Farm sector GVA grew more than one-fourth last quarter, against growth of 10.8% YoY in 4QFY21 and a contraction of 16.1% YoY in 1QFY21. This clearly implies that a low base was the primary source of dramatic growth in Non-Farm sector GVA in 1QFY22 *(Exhibit 9)*.

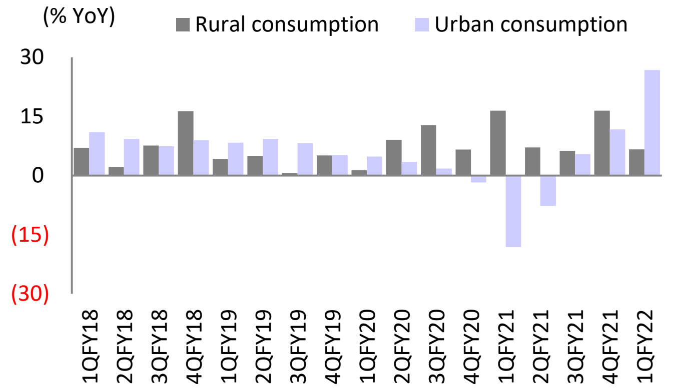
Notwithstanding the source of growth in the Non-Farm sector, its outperformance implies that urban consumption beat rural consumption in 1QFY22 *(Exhibit 10)*.

Exhibit 9: Non-Farm GVA growth surpassed Farm GVA growth in 1QFY22…



Please refer to our recent report on Economic Activity Index

Exhibit 10: …implying higher urban consumption v/s relatively modest rural consumption



Source: Various Other Source, CEIC, MOFS

A simple average of 13 indicators used to estimate rural consumption on a yearly basis up to FY21 shows that growth was weak at an average of 3.1% YoY in the initial five years of the century, followed by an average 9.9% YoY growth over the next 10 years. Rural consumption, however, weakened during FY15–17 to average growth of 2.2%, before recovering to average growth of 4.9% during FY18–20. An unprecedented global pandemic in FY21 caused rural consumption growth to slow to just 2% YoY. This was caused by indicators like negligible railway passenger traffic; decline in IIP-food products; a second consecutive contraction in two-wheeler sales; and lower agriculture GVA, fertilizer sales, and water reservoir levels *(Exhibit 11)*.

Exhibit 11: After a rebound in FY18, rural consumption averaged 4% YoY during FY19-20 followed by 2% YoY in FY21

Rural economy Indicators, % YoY	FY00-04[1]	FY05-09[1]	FY10-14[1]	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Agri nominal GVA	5.0	11.7	15.4	8.7	6.4	13.1	12.4	6.6	12.5	6.6
Real agricultural wages	(0.2)	0.3	6.9	1.5	1.4	1.8	4.0	2.7	(3.0)	0.3
Real non-agri rural wages	(0.1)	(1.1)	5.2	2.7	2.3	1.0	2.3	1.9	(3.1)	1.0
Two-wheelers	9.7	7.1	15.1	7.9	3.4	6.9	14.8	4.9	(17.8)	(13.2)
Terms of trade	(7.6)	0.6	4.2	6.4	10.8	3.1	0.1	(4.9)	5.8	5.8
Domestic tractor sales	(6.7)	12.0	19.9	(10.0)	(8.9)	15.7	20.5	9.5	(10.5)	26.5
Farm exports	4.5	20.2	20.8	(27.7)	(20.8)	0.1	13.2	3.0	(8.4)	23.8
Fertilizer sales	2.2	7.9	1.7	10.6	7.1	(7.0)	1.8	3.6	5.9	3.3
Agricultural credit	18.8	28.8	14.6	15.0	15.6	12.4	3.8	7.9	4.2	12.3
IIP: Food products	4.6	(2.5)	4.5	6.0	(5.6)	(5.6)	9.4	12.2	2.0	(2.6)
Water reservoir levels	0.9	8.6	6.4	(10.4)	(16.2)	11.2	(5.1)	5.6	31.8	5.4
Railways passenger traffic	2.4	6.6	3.5	(2.2)	(1.0)	0.8	0.9	1.7	(4.0)	(84.1)
Fiscal rural spending	7.3	37.7	0.6	7.8	6.4	15.9	14.1	5.1	25.0	41.0
Rural consumption*	**3.1**	**10.6**	**9.1**	**1.2**	**0.1**	**5.3**	**7.1**	**4.6**	**3.1**	**2.0**

Source: MOFSL, Company

[1] Simple average of growth obtained during those years
* Simple average of growth in all indicators in that year
Source: CEIC, CSO, RBI, Various National Source, MOFSL

Similarly, 10 indicators used to estimate urban consumption on yearly basis show that it was very strong during the first decade of the century, with average growth of 14.7% YoY during FY2000 to FY2009. Growth then moderated to an average of 9.5% during FY10 to FY19. However, in FY20, urban consumption contracted 0.3% YoY due to worse performance in all 10 indicators in our analysis. In fact, indicators such as passenger vehicle sales, IIP consumer durable goods, airline passenger traffic, and non-farm consumer imports contracted during the year vis-à-vis growth in previous years. Come FY21, the pandemic exacerbated the situation and urban consumption collapsed by 8.8% YoY during the year *(Exhibit 12)*.

Exhibit 12: Urban consumption contracted 0.3%/8.8% YoY in FY20/21 after averaging 10.6% YoY between FY00 and FY19

Urban economy Indicators, % YoY	FY00-04[1]	FY05-09[1]	FY10-14[1]	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Non-farm real GVA	10.9	16.8	14.1	11.5	9.9	10.6	10.7	11.6	6.5	(5.1)
Employee Cost - BSE500	n/a	n/a	n/a	6.6	17.3	3.3	7.8	13.2	3.0	(2.8)
CPI inflation	5.4	5.0	9.6	5.7	4.9	4.7	4.8	5.6	3.6	5.2
PVs sales	15.4	11.7	10.9	3.7	7.3	9.2	7.9	2.7	(21.6)	(6.1)
Personal credit	35.7	26.5	12.5	15.5	19.4	16.4	17.8	16.4	15.0	10.2
IIP: Cons durable goods	9.1	21.4	8.9	4.0	3.3	3.0	0.8	5.5	(8.8)	(11.0)
Airline passenger traffic	5.5	20.7	8.9	17.0	19.2	20.0	18.1	13.0	(1.4)	(66.5)
Petrol consumption	7.5	7.4	8.8	11.4	14.5	8.8	10.1	8.1	6.0	(6.7)
Real house prices	n/a	5.5	8.5	9.1	5.1	3.3	1.0	(1.8)	(1.1)	(1.1)
Non-farm consumer imports	22.9	23.1	6.2	13.7	6.6	4.5	21.6	7.3	(3.7)	(4.2)
Urban consumption*	**14.1**	**15.3**	**9.8**	**9.8**	**10.8**	**8.4**	**10.1**	**8.1**	**(0.3)**	**(8.8)**

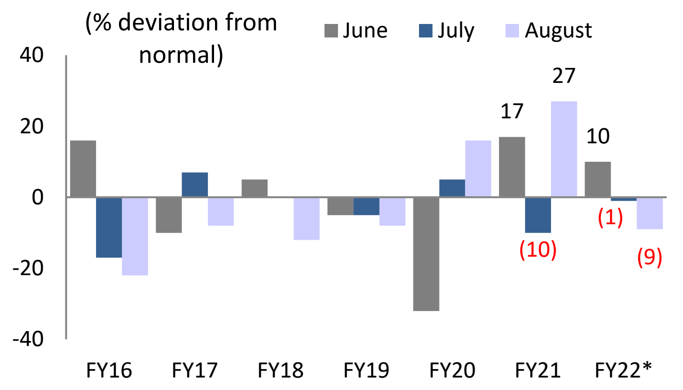
Source: MOFSL, Company

[1] Simple average of growth obtained during those years
* Simple average of growth in all indicators in that year
Source: CEIC, CSO, RBI, Various National Source, MOFSL

The Farm sector has not been too favorable this time around…: Compared with last year, the Farm sector has not been that promising this year; the following is a list of factors indicating the same:

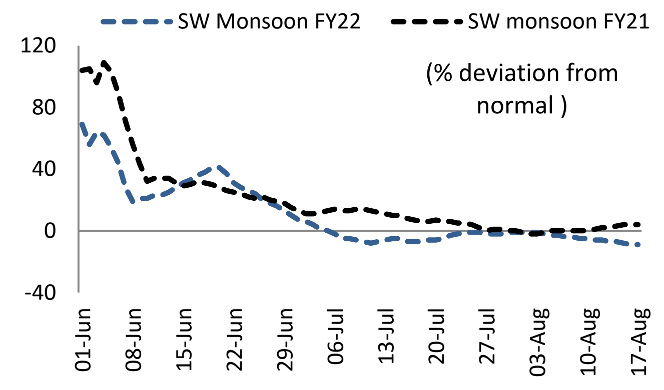
1. Compared to FY21, southwest monsoon rainfall started on a relatively low note but it eventually performed better in Jul'21 (v/s Jul'20). In Aug'21, however, rainfall has performed very badly compared to Aug'20. In fact, barring the eleven days between 15th to 25th Jun'21, southwest monsoon has performed consistently worse this year compared to the last (*Exhibits 13, 14*).
2. Kharif sowing in the first week of Aug'21 stood at 93% of the normally sown area, lower v/s 95% last year (E*xhibit 15*).
3. On the brighter side, water reservoir levels at 61% of live storage as of 13th Aug'21 were higher than 54% during this time last year (E*xhibit 16*).

Exhibit 13: While rainfall in Jul'21 was better than previous year, that in Aug'21 is performing worse



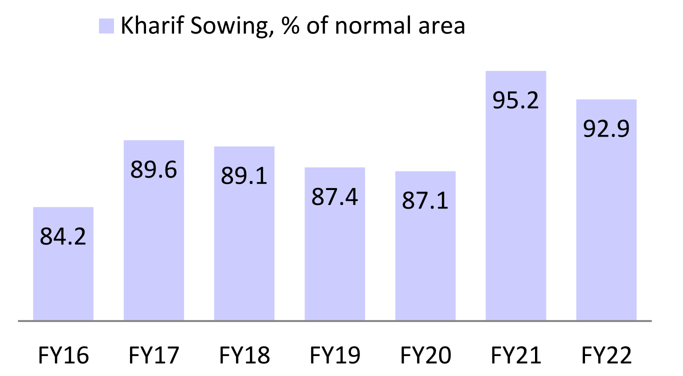
Deviation in rainfall in that month

Exhibit 14: Southwest monsoon performance in FY22 consistently worse than in FY21



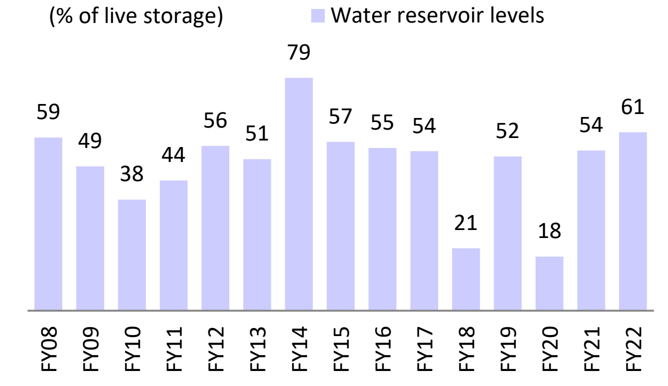
Source: IMD, CEIC, MOFSL

Exhibit 15: Kharif sowing has been slightly modest this year v/s last year…



Mid- August for all years

Exhibit 16: …but water reservoir levels in FY22 thus far are at an eight-year high



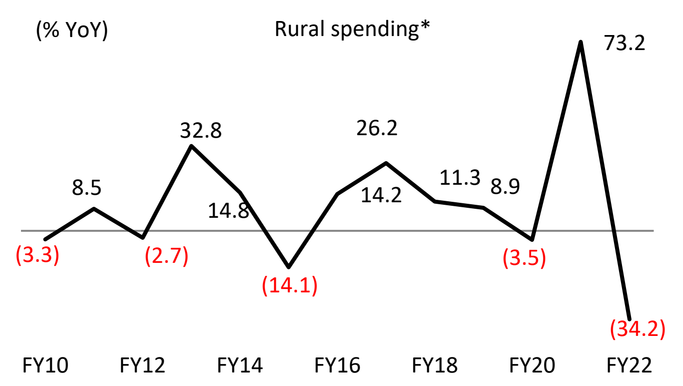
Mid- August for all years

Source: CSO, RBI, Various Other Source, CEIC, MOFSL

…and government support also seems to be tapering off: The government was sympathetic towards the rural sector last year. However, this support seems to have been tapered off this year:

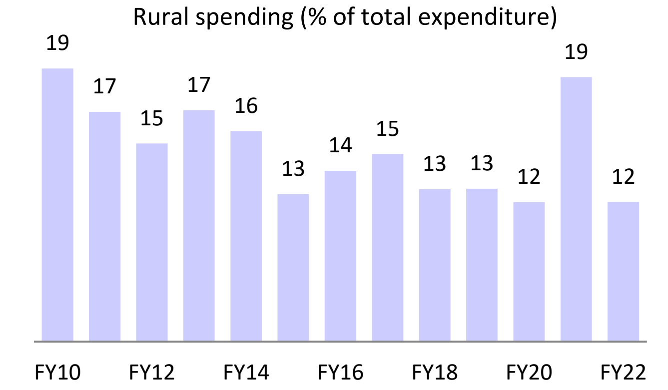
1. Rural spending by the government (including the Ministry of Agriculture and Farmer's Welfare, Department of Fertilizers, Drinking Water and Sanitation, Ministry of Panchayati Raj and Ministry of Rural Development) contracted 34.2% YoY in 1QFY22, the lowest growth in at least 14 years. This led to government share of just 12% in total expenditure in 1QFY22, down from a very high share of 19% in 1QFY21 *(Exhibits 17, 18).*
2. Finally, the 'terms of trade' for the Farm sector have also worsened. Based on five items (high-speed diesel, electricity, fertilizers, pesticides, and agricultural machinery and implements), we estimate that while farm input prices grew sharply by 16.2% YoY, output prices grew just 6.4% YoY in 1QFY22, implying unfavorable terms of trade for the farmers *(Exhibits 19, 20***).**

Exhibit 17: Government rural spending contracted sharply in 1QFY22…



1Q for all years

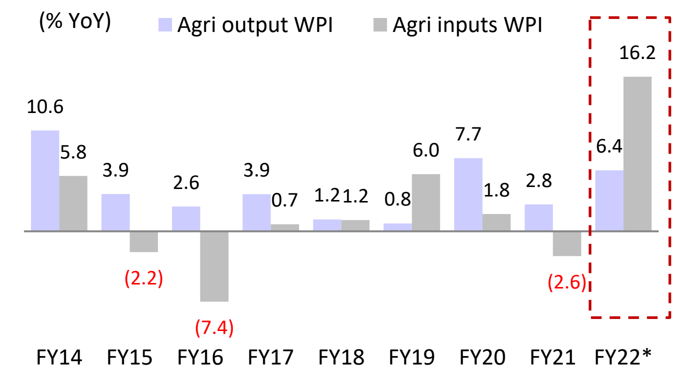
Exhibit 18: …leading to a lower share of rural spending in total expenditure by the government



1Q for all years

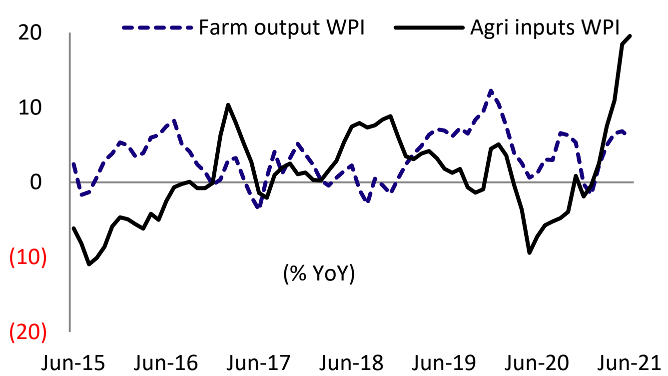
Source: CGA, CEIC, MOFSL

Exhibit 19: 'Terms of trade' for the Agricultural sector were exceedingly unfavorable in 1QFY22…



1QFY22 v/s 1QFY21

Exhibit 20: …due to a sharp rise in input costs compared with output prices



Source: OEA, CEIC, MOFSL

Conclusion

The second COVID wave shook the entire nation. After reaching lows of only 14k new cases on average during Jan–Feb'21, daily new cases reached highs of 414k as of 7th May'21, marking the peak of the second wave. While the COVID-19 affected primarily the urban sector initially, almost three quarters of new infections over May–Jul'21 were found in the rural districts of the country.

Thus, we re-examined rural and urban consumption trends to analyze the adverse impact of the (national) lockdown during the first wave with that of the (localized) lockdowns during the second wave. Using multiple proxy indicators, our analysis showed that the adverse impact of the second wave was not very large on rural society. While rural consumption did weaken, it was still strong compared with pre-COVID years.

On the contrary, natural factors such as the southwest monsoon rainfall and kharif sowing are performing worse this year v/s the last. Besides this, government rural spending plunged in 1QFY22 and farmers' terms of trade are exceedingly unfavorable this time around.

Therefore, the five key takeaways from our analysis are as follows:

1. Economic indicators suggest that the rural sector did weaken a bit during the second wave, but the situation was not as bad as was feared.
2. The very high urban consumption during 1QFY22 does not necessarily imply a rebound in consumption demand as much of it was due to a very low base.
3. A Weak Farm sector (due to frail government aid and worse natural factors) within the rural sector does not bode well for the overall rural economy.
4. Although the second wave has subsided, the fear of a potential third wave could derail economic growth once again.
5. Although we believe real PCE may see a sharp rebound in 1QFY22 primarily due to a low base, sustained consumption growth in subsequent quarters would eventually matter for economic recovery as a whole.

NOTES

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